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ABSTRACT

This booklet is intended to help students gain a broad understanding of the meaning, characteristics, organization, products, and functions of the insurance industry. The following topics are discussed: the concept of and need for insurance; basic principles of insurance (risk assessment, insurability and insurable interest, determination of risk); insurance policies as legal contracts (components and importance of clear contract language); the role of government in insurance (as an insurance regulator and as a program provider); organization and operation in the insurance business (types of insurance organizations, the insurance product system, the structure of insurance operations, other operational structures); insurance careers (major insurance careers and other related careers); and challenges of today's insurance industry (the current scene, health insurance, life insurance, property and casualty insurance, and responses to industry challenges). Each section concludes with a self-quiz. (MN)

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Welcome to the Insurance Industry

Purpose of This Booklet

This booklet introduces the insurance business and provides a broad understanding of the meaning, characteristics, organization, products, and functions of the industry. After studying the booklet, the reader can expect to have attained general knowledge of how insurers operate.

Many people in various job descriptions participate in the development, issuance and sale of insurance products. This introduction to insurance will aid the reader in understanding the diversity of these cooperative activities and of the way they contribute to the protection of consumers from various types of financial loss.

The educational staff of the Health Insurance Association of America (HIAA), together with Association colleagues and industry people who cooperated in development of this booklet, hope that it will stimulate interest in the insurance business, encourage further study about it, or be an initial step toward a rewarding career in an exciting and changing industry.

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What is Insurance?

Key Terms

Economic Loss
Hazard
Insurance
Premium
Rating
Risk
Risk Management

After completion of Chapter 1, a student should be able to:

. . . explain the concept of insurance
. . . explain what constitutes an insurable risk
. . . state three uses of an insurance premium
. . . give evidence for the usefulness of insurance

What is Insurance?

Insurance is a PLAN of RISK MANAGEMENT that, for a price, offers the insured an opportunity to share the costs of possible ECONOMIC LOSS through an entity called an INSURER.

. . . A Plan of Risk Management

The importance of planning even simple activities is a recognized need in daily life. How much more essential is an overall lifetime plan, one that includes accessing and assigning portions of financial resources to goal accomplishment. A part of this planning includes making provisions for eventualities that might interfere with goal fulfillment and require re-direction of financial resources. These eventualities, called RISKS, involve the possibility of ECONOMIC LOSS—the unintentional parting with something of monetary value. A person protects against such financial losses when evolving a lifetime plan through the concept of INSURANCE.

RISKS, or HAZARDS, as they are sometimes called in the insurance industry, include personal, property, and liability risks. These risks can be handled through proper planning, or RISK MANAGEMENT.

RISK MANAGEMENT is an organized plan of financial protection that persons devise to deal with life's common hazards.

Insurance is an important part of managing the three main categories that involve risks.

. . . Personal risks— including the uncertainties surrounding loss of life, health or income due to untimely death, illness, disability, unemployment or old age.

. . . Property risks— dealing with direct or indirect losses to personal or real property due to fire, wind, accident, theft and other hazards.

. . . Liability risks— involving losses due to negligence resulting in bodily harm or property damage to others. Such damage could be caused by an injury on one's own property, by an automobile, by professional misconduct, etc.

These three types of risks are considered insurable because they are pure risks. Pure risks are accidental and unintentional, and there is no possibility of financial gain—only of financial loss. In contrast, speculative risks—such as purchasing stock—offer the chance of loss or gain and are not subject to insurance coverage.

Coping with pure risks requires considerable insight, knowledge, and projection. Health care costs, increase in life expectancy, and political developments, for example, are all external facts that impact on a risk management plan. People use the following techniques, singly or in combination, to develop a viable plan of risk management:

Avoidance— A person can take individual action to eliminate risky situations. A

part-time pilot might decide to give up this avocation, for example.

Prevention/Reduction— A person could prevent or reduce the chance of high blood pressure by proper diet, exercise and stress management.

Personal Assumption— A person may decide to take full economic responsibility for some risks. A single person without dependents, for example, may choose to purchase relatively low amounts of life insurance.

Sharing— Persons may choose to spread or "pool" the effects of a risk. Group life and health plans are examples of this strategy.

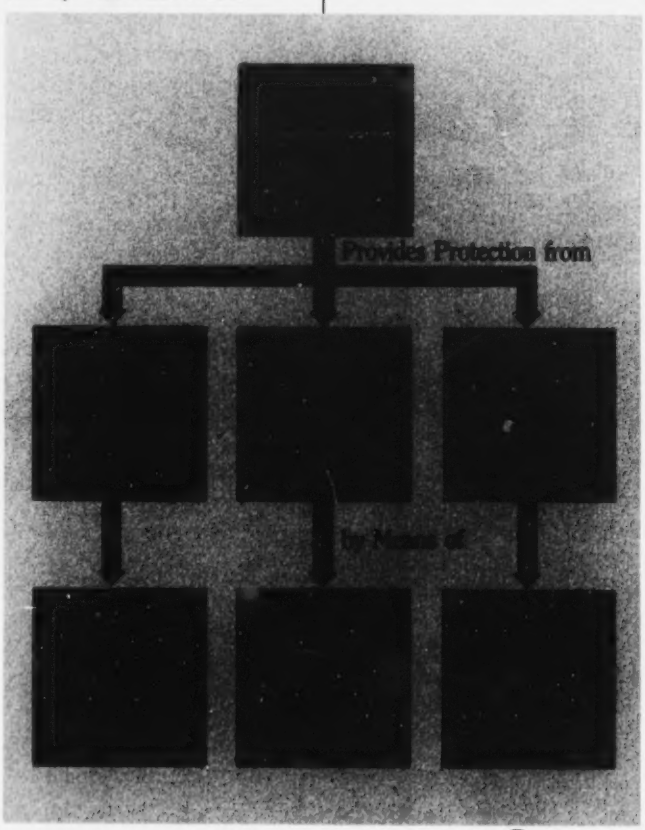
Transfer— In certain situations, people can transfer responsibility for financial losses to another person or institution. Retired persons, for example, can transfer some costs of health care to government programs.

Insurance companies use the concepts of risk sharing and accepting the transfer of risks. They also have learned the wisdom of insuring a large number of *similar* risks. Some losses are more regular and thus more accurately predictable. Insurers use this principle of "spreading the risk" in developing price.

As in the production of all goods and services, insurers offer their product—THE INSURANCE POLICY—to buyers (called POLICYHOLDERS) for a price. This cost includes an assessment of initial and continuing expenses, both actual and contingent, creation of a "pool" from which to pay claims, and a contribution to the insurer's investment income from which the insurance company supports the overall operation and development of the business, thus keeping down the premium amount the policyholder pays. This cost to the consumer, paid periodically, is called a PREMIUM. The process by which the cost is determined is called RATING or RATE-SETTING.

The main kinds of risks that private insurers offer protection from can be seen from the following chart.

Under these major divisions, insurers deliver protection from related risks, working with policyholders, governmental agencies and health care providers to meet both the needs of the individual policyholder as well as those of the society in which the insurer operates its business.

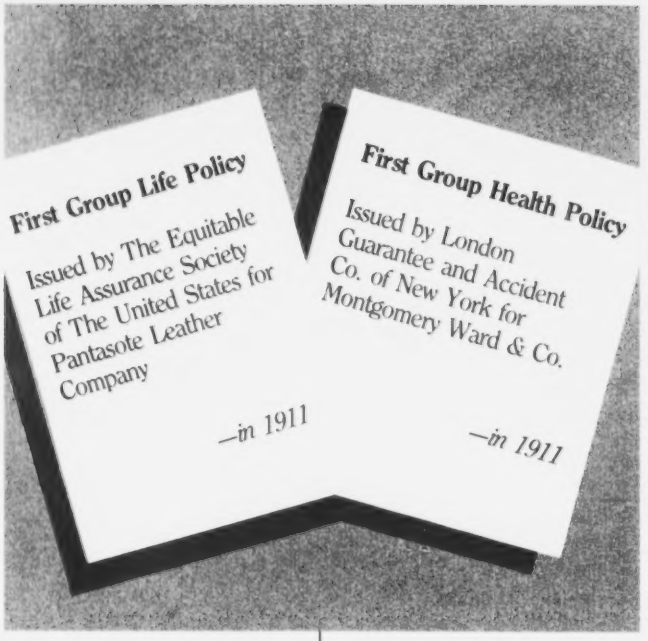


Evolution of the Concept of Insurance

Life Insurance

As early as the 1790's, chance played an important part in the life insurance being written to insure the lives of ship's captains and merchants. In the Netherlands and in France all life insurance was considered mere wagering and was, therefore, illegal. In England, during the reign of Elizabeth I, life insurance contracts were openly wagered. This led to the English Parliament enacting a law against wagering insurance contracts and to other developments which were to make life insurance possible on a scientific basis rather than the basis of mere chance.

Obviously, life insurance was not a significant factor in the lives of the early settlers in the United States. What pioneer, motivated by need or adventure, was concerned with the security offered by life insurance? But the society changed early in the nineteenth century. The growth of urban life and the supply of money stimulated interest in security and financial protection. Life insurance companies sprang into being with


First Group Life Policy
Issued by The Equitable Life Assurance Society of The United States for Pantasote Leather Company
—in 1911
First Group Health Policy
Issued by London Guarantee and Accident Co. of New York for Montgomery Ward & Co.
—in 1911

aggressive sales techniques; life insurance in force by the outbreak of the Civil War had risen a spectacular 3000 percent from its beginning.

Many changes in the types of coverage and structure of the industry took place during the mid-1800's. Then, with the Industrial Revolution, life insurance became a large-scale national institution, fulfilling its dual role of protecting individuals and investing in the nation's economy.

Health Insurance

Health insurance, limited primarily to disability income in case of accident, existed in the early history of Rome, England, and Germany. It also was written in one form or another throughout Eastern Europe and in Russia into the early 1900's. With the National Health Insurance Act of 1911, England took a giant step toward modern-day concepts of health insurance covering the costs of outpatient care and wage loss during sickness. This Act set the stage for social insurance and led ultimately to enactment of Britain's National Health Service legistation in the mid 1940's. England's activity generated interest in insuring groups for illness and non-work injuries in the United States.

During the decade of 1910 to 1920 life insurance was the principal type of group insurance written in the U.S. The only available form of group health insurance was disability income benefits for temporary disability due to non-occupational accident or sickness.

After the 1930's, the emphasis on medical care and medical care expense benefits was tremendous. Stimulus for the emphasis can be traced to the migration from farm to city and the consequent increase in the use of hospital services. Advances in technology in the fields of medicine and surgery also were contributing factors.

In the 1940's disability expense benefits for long-term disabilities emerged. At the same time hospitals and private insurers developed hospital expense benefits, which later expanded to surgical and medical benefits.

Property and Casualty Insurance

Marine insurance written on ships and cargoes, probably the earliest known form of insurance, goes back to the early Middle Ages. In the early colonial days of America there was some underwriting of marine risks, an office being opened in New York City in 1759. The first American company, the Insurance Company of North America, was formed in 1792. Growth of the industry followed, beginning with the advent of the clipper ships in the mid-1800's.

The earliest records of fire insurance followed the great London fire of 1666. The first American company operated under a royal charter in 1735. The "Philadelphia Contributionship for the Insurance of Houses from Loss by Fire" organized in 1752, is the oldest fire insurance organization in the United States that continues to exist. Fire insurance grew significantly with the growth of cities and the expansion of transportation and banking facilities.

Casualty insurance in America dates back to 1832, in the form of burglary or housebreaking insurance. The Travelers Insurance Company wrote the first accident insurance in 1863 and auto liability insurance for bodily injury in 1898.

Who Needs Insurance?

Today, almost everyone needs insurance.

Despite all precautions, we can't completely avoid risks. Accidents, sickness, death, fire, earthquakes, tornadoes, lightning, theft, criminal assaults—these are just a few of the dangers we face. The consequences that may result from these hazards move across the full spectrum from unpleasant to calamitous.

The impact of occurrences such as those mentioned above are both physical and economic. A homeowner's loss of a home through fire could represent the loss of most of his/her wealth. An injury may prevent a person from earning a salary for a period of several years—perhaps for a lifetime. An automobile worth thousands of dollars can be wrecked in an instant.

Insurance helps individuals minimize the financial loss from such sudden and unexpected events. It operates by spreading this risk over a number of people, so that the many people who *could* have the loss, but *do not*, help to repay the loss of those few who *do*.

Obviously, insurance does not prevent the physical occurrence from taking place. Owning an insurance policy will not keep a house from burning down, nor a car from colliding with another, nor a person from collapsing from a heart attack. It does, though, help to alleviate the financial problems created by such events. To this extent, insurance plays an important part in maintaining the insured person's sense of security.

In addition, insurance helps society by reimbursing people and businesses for covered losses, encouraging accident and risk prevention, providing funds for investment in developmental projects, and enabling people to borrow money to build their own futures and meet their personal goals.

Test Yourself

Answer True or False.

1. Purchase of insurance eliminates the risk of economic loss. _____
2. An insurer pays benefits to an insured from a fund accumulated from the premiums of many policyholders. _____
3. An auto accident or a fire are examples of unpredictable, insurable pure risks. _____
4. The concept of insuring risk originated in the 20th century. _____
5. Insurance performs both a personal and a social service. _____

Answers

1. False
2. True
3. True
4. False
5. True

Basic Principles of Insurance

Key Terms

Adverse Selection
Coverage
Evidence of Insurability
Insurability
Insurable Interest
Law of Large Numbers
Morbidity
Mortality
Principle of Indemnity
Probability
Residual Market Programs
Risk Classification
Risk Selection
Standard Risk
Underwriting

After completion of Chapter 2, a student should be able to:

- ***. . . state and explain the concepts of Probability and the Law of Large Numbers***
- ***. . . explain what constitutes insurable interest***
- ***. . . list four requirements for an insurable risk***
- ***. . . explain why an insurance company might reinsure a risk***
- ***. . . discuss how and why insured persons are divided into classes***
- ***. . . explain the major job responsibility of an underwriter***
- ***. . . state how a group risk is assessed***

As discussed in Chapter 1, the insurance industry has come a long way from the products and methods of its beginnings. Today, sound business principles underlie the operation of the industry—principles which, in general, guarantee present and future protection of policyholders.

Risk Assessment

When considering the issuance of an insurance policy, the insurer views risk as the probable amount of loss. Correct measurement and assessment of the loss potential form the foundation of any system of insurance. Such assessment is done through the application of two mathematical principles or laws: PROBABILITY and the LAW OF LARGE NUMBERS.

Probability

PROBABILITY can be called the mathematics of chance. "What are my chances?" is a frequently asked question—when we assess both trivial matters such as taking a chance on a lottery ticket, or more serious ones such as the likelihood of recovery after surgery. The chance of something happening (or NOT happening) within a certain number of tries is the basis for the theory of probability.

Let's suppose you walk into a conference room in which seven people are assembled. Four of these people are underwriters; three are actuaries. The probability (assuming you don't know the people) of your pointing out an underwriter can be expressed in several ways: 4 chances in 7; 4/7; or as a 57% probability (4 divided by 7).

In situations that involve a few controllable elements—the two-sided coin, for instance, where the probability of tossing "heads" is 1 chance in 2—probability theory is a fairly accurate predictor.

But human beings and their behavior are not so controllable or predictable. Yet, insurers need to know what to expect from the people they insure. A second principle helps insurance companies find out more about the risk involved in insuring these people.

The Law of Large Numbers

If you toss a coin 1,000 times, what is the probability of "heads"? The probability can be expressed as a fraction, a decimal, or a percentage.

A coin is expected to land "heads up" 500 times out of 1,000 tosses. The probability of its landing heads up is expressed as:

$$\frac{\text{Numerator = number of times the event is expected to happen}}{\text{Denominator = number of times the event in question could happen}}$$

(all tosses could be heads)
or .50
or 50%

Example: An insurance company issued hospital expense insurance to 10,000 insureds. One out of every 100 of these insureds is expected to be hospitalized this year. What is an insured's probability of hospitalization?

($\frac{1}{100}$ or .01 or 1%)

The "law of large numbers" is an important concept in prediction. If we observe a great number of events which seem to happen by chance, the actual observations will closely approach the theoretical result indicated by the mathematics of probability.

Statistics from a study of the number of automobiles in a given area at certain hours on a Saturday night, and the number of accidents which actually occurred during that time, become more reliable as the number of automobiles observed increases. The number of accidents occurring per 5,000 automobiles is a more reliable basis than the number per 100 for predicting the probability of automobile accidents occurring during the same time period. However, the theoretical result of a series of chance happenings can rarely be obtained in a small-scale application.

Example: Put 10 pieces of construction paper (5 of one color and 5 of another color) in an envelope. Select one at random, note the color, and return it to the envelope. Follow this procedure until you have selected and replaced 10 pieces. How many of each color did you select? According to the law of probability, you should have selected 5 of one color and 5 of the other. But you were working on a small scale. If your sample had consisted of 1,000 pieces, then, according to the law of large numbers, the more you withdrew and replaced the closer the actual result would be to the theoretical probability.

Thus, the LAW OF LARGE NUMBERS, commonly known as the "Law of Averages," briefly stated, says that actual results tend to equal the mathematically expected or probable results as the number of happenings observed are increased. Therefore, since certain happenings occur repeatedly, statistics from a great number of happenings provide reliable information for predictions that are useful in ratemaking and in risk selection.

This is why insurance companies use large groups of people in their statistics. To write a single life insurance policy for $10,000 would be gambling all or nothing. But insuring 500,000 people, each paying a premium for $10,000 of coverage, would bring down the degree of risk considerably, and make a prediction of probability quite accurate.

Insurability

Whether or not an insurer accepts an applicant depends on a concept called INSURABILITY, loosely defined as an acceptable, insurable risk. (It is well to note that the term "risk" applies not only to "chance," as previously discussed, but also to persons or things. A building, for example, is a fire insurance "risk"; an employer and employees is a group health insurance "risk"; and a driver of an auto is a "risk"; etc.) Insurers have to deal with uncertainty as a way of life. The degree of that uncertainty is the risk insurers assume when a policy is written.

Insurance is sold only to people who would suffer a genuine loss should the event insured against occur—that is, to someone with an INSURABLE INTEREST in the thing or person to be insured. A business owner, for example, could buy insurance on the building which he/she owns and in which the business operates. An insurance company, however, would NOT sell a similar policy to a person who merely works in the building, since this person does not have a financial investment in the structure. A life insurance policy could be issued to a husband or a wife for a

spouse; such a policy would not be issued, however, to co-workers who, generally, do not have an insurable interest in one another.

In certain business situations, such as a partnership, each partner has an insurable interest in the life and health of the other. Also, a creditor, who stands to lose money if a debtor dies, may purchase insurance to guarantee repayment of the debt. This is an example of the INDEMNITY PRINCIPLE, which holds that the owner of an insurance policy should be fairly compensated for a loss—but not allowed to profit by it.

Not all losses are insurable. People lose and misplace items of little monetary value every day. Insurance covers only losses that create economic hardship and that have certain characteristics:

1. The loss is a significant one.
2. The amount of the loss can be determined.
3. The loss results from an unexpected and unintended event. (Death, for example, covered by life insurance, is certain but its timing is not.)
4. The insurer is capable of assuming the risk. Cataclysms, such as earthquake and war, are not insurable risks, due to the tremendous degree of the loss.

However, certain other potentially large risks, such as catastrophic illness, can be "reinsured" by an insurance company spreading or sharing the risk with one or more other insurers, in exchange for all or part of the premiums.

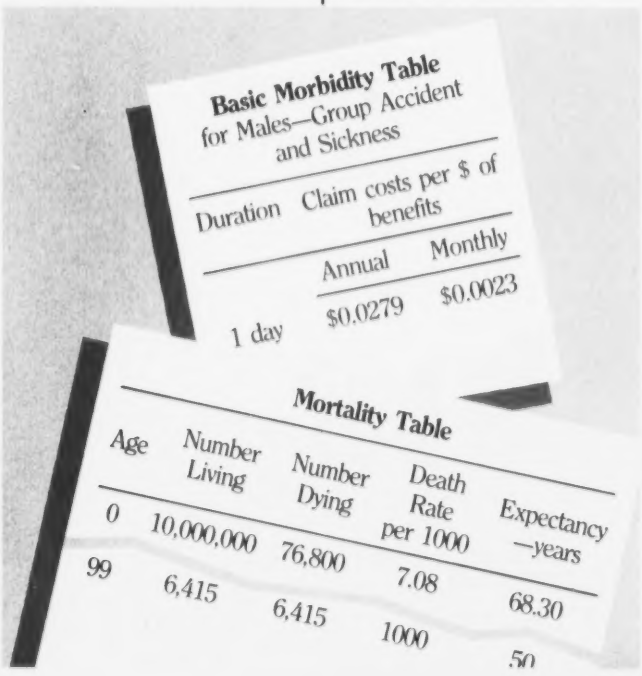
Determination of Risk

Naturally, an insurer tries to minimize the degree of insurable risk as much as possible. Within calculable limits, insurers are able to foresee the normal losses and estimate catastrophic losses so that premium charges can be calculated which are adequate for expenses and leave something for profits.

Life insurance companies use MORTALITY tables which summarize, by different age groups, data that indicates the probability of living or dying.

Health insurance companies use MORBIDITY tables which provide data on the probable frequency and severity of sickness or accident in a well-defined class of persons.

Property and casualty companies use a variety of statistics, loss control surveys, and other assessment-of-risk instruments to determine insurability.



Basic Morbidity Table
for Males—Group Accident and Sickness

Duration	Claim costs per $ of benefits	
	Annual	Monthly
1 day	$0.0279	$0.0023

Mortality Table

Age	Number Living	Number Dying	Death Rate per 1000	Expectancy —years
0	10,000,000	76,800	7.08	68.30
99	6,415	6,415	1000	.50

All applicants for insurance are divided into such limited, well-defined classes through a method known as RISK CLASSIFICATION. Deciding who and what risks are insurable and the basis of the acceptability to the insurer is the risk selection process called UNDERWRITING. Underwriters attempt to prevent ADVERSE SELECTION or the tendency for poor risks to affect the insurance pool.

The term "underwriting" has an interesting history. Initially, it referred to someone willing to assume all or part of the risk in a business venture. During the seventeenth century, groups of merchants would gather at Lloyd's of London with interested insurance persons to decide, for instance, the conditions and terms for insuring sailing vessels about to set out on a voyage. Gathered at a coffeehouse, the merchants would circulate their proposals, and brokers who specialized in marine insurance would write their names at the bottom of those proposals for which they were willing to assume all or part of the risk. Their practice of signing their names under the proposal was the origin of the term "underwriter."

Risk Classification

An applicant for an insurance policy may wonder why he/she was asked so many personal questions such as

—age
—sex
—past and current health habits, such as smoking
—occupation or hobby
—mileage and type of auto use
—location of fire hydrants
—types of door locks

These and similar questions are an attempt by insurers to charge the fairest possible price for COVERAGE—the term used to describe both the specific protection the insured is to receive (hospital expense coverage, disability income coverage) and the *kind* of insurance held (major medical coverage, auto or property coverage).

Risk classification makes it possible to provide coverage to nearly everyone, at a price that is fair to each policyholder. Several developments have contributed to this high rate of acceptance (about 98%) for life and health insurance applicants. Advances in medicine, job safety and public health have allowed the classification of many more people as "standard risks." Each such risk pays the normal premium for a person of a certain age and sex.

Property and casualty insurance utilizes "assigned risk" plans and FAIR plans through RESIDUAL MARKET PROGRAMS that provide insurance services outside the normal risk pool. These programs provide state-mandated underwriting by regular insurers to persons who have been rejected through the regular voluntary insurance market.

Classifying Individual and Group Insurance Risks

Insurers issue various kinds of life and health insurance coverage to individuals who give the insurance company satisfactory EVIDENCE OF INSURABILITY—any statement or proof of a person's physical condition and other factual information affecting acceptability for the insurance applied for. However, most people with health insurance have group policies as members of an employee group. Here, the risk is measured on the composition of the entire group, and the health experience of the group over the course of a year.

Summary

Therefore, we can see that the basic principles of insurance involve methods of assessing the kind of risk, determining insurability, determining the degree of risk and classifying risk. These principles are used by all insurers, no matter what type of insurance products are sold. After risk is assessed, the insurance policy can be written. Chapter 3 explains the insurance policy.

Test Yourself

Select the term in Column A that relates to the statement in Column B.

Column A

1. Indemnity Principle
2. Reinsurance
3. Probability
4. Law of Large Numbers
5. Underwriting
6. Morbidity
7. Evidence of Insurability
8. Standard Risk
9. Mortality
10. Insurable Risk
11. Group Insurance
12. Insurable Interest

	Column B
A_____	10 people draw a ticket from a hat to decide who will win a prize. The chance is 1 in 10.
B_____	Actual results of how often an event occurs tend to equal what is mathematically expected as the number of happenings increase.
C_____	Information that proves a person is eligible for insurance.
D_____	A policyholder should be fairly compensated for a loss, but not make a profit from it.
E_____	An unexpected loss that creates an economic hardship.
F_____	Frequency and severity of sickness or accident.
G_____	Determination of the basis for policyholder acceptability by the insurer.
H_____	Pays the normal premium for a person of a certain age and sex.
I_____	Overall risk is determined based on the members insured under the plan.
J_____	A way insurers share their risk.

Answers

A. 3
B. 4
C. 7
D. 1
E. 10
F. 6
G. 5
H. 8
I. 11
J. 2

Chapter 3

The Insurance Policy: A Legal Contract

Key Terms

Claim
Consideration
Contract
Exclusion
Insuring Agreement
Insuring Clause
Loss
Policy
Premium Rate

After completion of Chapter 3, a student should be able to:

- ***. . . distinguish between a policy and a contract***
- ***. . . list and explain the four components of a legal contract***
- ***. . . explain why insurance contracts carefully define terms***
- ***. . . explain how an insurer assigns a premium rate***

At times people who sign an insurance contract have only a vague idea of what it is they are signing. But there is nothing "tricky" or mysterious about it. It is simply a legal contract that binds both the insurance company and the policyholder to certain agreements. Although an insurance contract and an insurance policy can be thought of as synonymous, for this discussion let's make a distinction between them. We will consider:

—the POLICY as the written evidence of specific insurance protection

—the CONTRACT as the legal description of the type and scope of insurance protection provided. The contract also identifies the rights and responsibilities of insurer and insured toward that protection.

Specific benefits or coverages are detailed in the INSURANCE AGREEMENTS. This is where purchasers find out what protection they get for the money they paid.

Components of a Legal Contract

In common with all contracts, insurance policies have four basic components. They are:

1. The contract is an agreement between two or more parties. State laws determine competency requirements—minimum age, for instance—which people need to meet to enter into a contract.
2. The contract is made by mutual consent—one party makes an offer; the other party accepts the offer. In legal terms this is called a "meeting of the minds."
3. The contract is entered into for a legal purpose.
4. The fourth component is called a "consideration"—what is exchanged (money or the premium in this case) for what is given (insurance coverage from LOSS). For the person insured, loss means the reduction in quality, quantity, or value of property, finances, or health. Loss, for the insurer, is defined as the amount of insurance or benefits for which the insurer is liable under the terms of the policy. When a policy is issued, the insurer assumes the risk in return for the payment of a PREMIUM by the insured.

PREMIUM RATES are determined according to mathematical formulas and statistical and judgmental considerations. A rate is, in effect, the price for a coverage, such as $10.20 per $1,000 of fire insurance coverage.

Contract requirements protect policyholders. To provide insurance, insurance companies must be licensed to issue policies in that state—and must provide a written contract which "spells out" the complete terms of the agreement.

Importance of Clear Contract Language

In addition to the agreements and coverages, policies define important terms and give full explanations of conditions

Test Yourself

COMPLETE each of the following statements:

1. Although the terms policy and contract are often used interchangeably in insurance, the word contract more accurately is applied to _____ .

2. One example of a contract drawn up for illegal reasons would be a life insurance policy entered into with the idea of killing someone. Another is _____ .

3. An applicant for insurance must be legally competent to enter into a contract. One example is that the person must be of legal age, according to state requirements. Another is _____ .

4. The "consideration" of the insured policyholder is the payment of premium. The "consideration" of the insurance company is _____ .

5. An insurance policy includes a statement that an insured's avocation, skydiving, is not within the scope of the policy coverage. This is an example of an _____ .

Answers

1. the legal description of the scope of insurance protection and of the rights and responsibilities of insurer and the insured towards that protection.
2. Example: burning down a building in order to collect fire insurance benefits.
3. Example: a person is mentally incapable of understanding what he/she contracts for.
4. the promise to pay benefits when a loss occurs—that is, the promise to pay lawful claims.
5. exclusion.

under which the coverages apply or do not apply. (Specific conditions or circumstances listed in the policy, for which the policy will *not* provide benefits, are called EXCLUSIONS.)

Here is where the legal characteristics assume prime importance. The scope of coverage established by the insuring agreements and the boundaries of that coverage are set by definitions and exclusions. Definitions and exclusions are in the policy to clarify and limit the scope of coverage. The contractual wording attempts to avoid misunderstanding, and is "legal" in nature because of the possibility of litigation when a dispute arises over coverage or policy interpretation. Recently, and legal language notwithstanding, insurance companies are producing policies in more readable, understandable form. If the language is not clear, courts usually interpret terms in favor of the insured.

Additional legal characteristics appear in the writing of conditions under which the insurer promises to meet its obligation to pay and conditions under which the policyholder is entitled to benefits.

When people buy an insurance policy—a health insurance policy, for example—they read the conditions under which the policy will pay in the INSURING CLAUSE which is part of the insuring agreement for each coverage. Note the following policy excerpt:

Accidental Death, Dismemberment and Loss of Sight Benefits Rider

If the insured employee has an accident while insured under this plan which results in certain losses, the insurer will pay the benefits listed in the Schedule below. The loss must take place within one year of the accident. The loss must be directly caused by the accident and must occur independently of all other causes. This benefit shall be subject to all of the other terms of this plan.

Thus, the policy says the insurer will pay a certain amount for financial loss due to accident according to benefits described. The insured requests such payment in the form of a CLAIM—a demand by the insured for benefits described in the policy after a loss occurs.

Chapter 4

Personal Insurance Products Offered by Private Insurers

Key Terms

Accidental Death and Dismemberment Insurance
Annuity
Cash Value
Coinsurance
Corridor Deductible
Credit Life Insurance
Disability Income Insurance
Endowment Policy
Face Amount
Health Insurance
Initial Deductible
Key Person
Life Insurance
Major Medical Insurance
Medical Expense Coverages
Negligence
Principal Sum
Reasonable and Customary Charge
Surgical Schedule
Term Life Insurance
Whole Life Insurance
Workers' Compensation

After completion of Chapter 4, a student should be able to:

- ***. . . explain the difference between whole life and term life insurance***
- ***. . . discuss the various ways life insurance offers financial protection to families and businesses***
- ***. . . describe at least five kinds of health insurance coverages***
- ***. . . distinguish between basic and major medical insurance***
- ***. . . explain the function of a deductible***
- ***. . . compare and contrast property and casualty insurance***

Introduction

Insurance policies are designed to meet specific needs of the public. In doing so, they provide many benefits beyond the direct benefit of protection against financial loss. In this sense, insurance products are not different from other products which serve a specific purpose and at the same time contribute certain social and economic benefits.

People buy benefits. They buy a product for what it will do for them. A power lawn mower may be a fine product but the buyer is mainly concerned with how evenly it cuts, how much time and effort it saves, and the attractiveness of the lawn after it has been used. A furnace may be constructed of the finest materials, but the buyer asks, "Will it keep me warm?" Insurance products, while just a few sheets of paper when purchased, become the difference between success and failure, survival and disaster, sickness and health when they are put to work at the time of the loss.

That is the economic protection people buy. And beyond protection are such social benefits as

—peace of mind
—keeping families and businesses together

—providing a basis for credit
—stimulating savings
—providing investment capital
—contributing to loss prevention

Life Insurance

One of the products of the industry classified under personal insurance is LIFE INSURANCE, designed to provide income for the survivors of an insured when he/she dies or to provide funds when an insured's income is reduced because of age. Insurers offer a number of different products under this main category. The coverage is offered two ways: WHOLE LIFE and TERM LIFE.

WHOLE LIFE INSURANCE provides protection for life and builds a CASH VALUE (the amount of money the insured can get if the policy is terminated).

Whole Life can be written three ways:
—as a STRAIGHT LIFE policy for an individual,
—as BUSINESS LIFE insurance for a business as protection against loss if a significant person in the firm dies (sometimes called KEY PERSON INSURANCE)
—as CREDIT LIFE INSURANCE, to repay a creditor institution the outstanding balance of a loan if the debtor dies.

TERM LIFE INSURANCE provides protection for a specified length of time, but with no accumulated cash value.

Term insurance has many uses in providing protection
—for a working person with a family
—for a business person during a time of financial strain
—for a business person as protection against a possible business loss
—for a new homeowner with a mortgage

Insurers also provide life insurance for employers, as group insurance "packages." In such cases insurance companies offer life with health insurance to employers for their employees. The employer is the policyholder in this concept.

Special Needs Covered by Life Insurance

All the above forms of life insurance deal with the death of an insured person. Insurers also have developed other life policies that provide, in addition to death benefits, income in specified situations.

Endowments— ENDOWMENT POLICIES provide funds for old age, education of children, and donations to a college, a church or a charity. These policies combine whole life insurance for a specified time and a fixed sum of money payable at the end of that time.

Example: A ten-year endowment policy for $5,000 will provide $5,000 life insurance for ten years. If the insured is still living at the end of that time, it will pay $5,000, the face amount of the policy. Another example of an endowment policy is a JUVENILE POLICY, a low-cost policy available for young people under age 15. It may be a twenty-year endowment or an educational endowment to pay out at age 18, or an "estate builder" policy which increases at a specific age to five times the original amount.

Annuities— Annuities provide income during the time of advanced age. They pay a fixed sum of money in a series of payments, usually monthly. For example, a $50,000 annuity pays an insured $100 each month for life beginning at age 65 until death, or a guaranteed amount each month for life or for a specified time (10, 15, 20 years) to the beneficiary if the insured dies during that specified time period.

Family Needs Policies— A person could also purchase life insurance that provides both life insurance protection as well as periodic income payments. Such policies are called FAMILY INCOME and FAMILY MAINTENANCE POLICIES.

Health Insurance

In addition to loss of life, loss of health is another vital area of economic risk that insurance covers. Accidents occur; illness and disability can result in considerable expense and loss of income. Essentially, insurers provide policies that pay the following health insurance benefits:

Kinds of Health Insurance	Benefits	Coverages
Accidental Death and Dismemberment (AD & D)	Payment for accidental death; loss of arm, leg, finger, etc.; loss of sight.	The full amount of insurance (the "PRINCIPAL SUM") is paid for death and for certain dismemberment losses, and lesser amounts for other dismemberment in proportion to the severity of loss.
Disability Income	Monthly or weekly income while disabled, temporarily or totally, from accident or sickness.	This insurance covers short-term disability income (up to 52 weeks) and long-term (up to age 70).
Basic Medical Expense	In- or out-of-hospital costs; physicians' services.	Hospital charges for room and board and other expenses are covered for a certain number of days or up to a specified amount. Physicians' charges are covered for treatment and visits and for surgery according to a fixed schedule or reasonable and customary charges.
	(A "REASONABLE AND CUSTOMARY CHARGE" is a charge for health care that is consistent with the prevailing rate in a certain geographic area for identical or similar services.)	
Major Medical Expense	Hospital/surgical and other medical care expenses in or out of the hospital in amounts beyond that provided by basic plans.	A major medical policy might provide a maximum amount such as $1,000,000 to cover a broad range of hospital room and board charges and other hospital expense, physicians' and surgeons' charges according to what is reasonable and customary, and other related expenses for examinations, prescription drugs, diagnosis and treatment.

Frequently asked questions, particularly in medical expense plans, are "Am I covered?" and "For how much?" An example might help in understanding how such coverage works.

The insured person first pays some "out-of-pocket" money before the insurance policy pays anything at all. This amount is called the INITIAL DEDUCTIBLE. In addition, the insurance company may pay only part—although the major part—of the cost of medical care. This concept is called COINSURANCE.

If a policy provides *basic* hospital benefits, room and board charges might be paid up to 31 days at a fixed rate, ($100 a day) and other hospital charges (X-ray, lab tests, etc.) paid up to a maximum amount (such as $2,000). Therefore, the maximum benefit payable for room and board would be $100 x 31 or $3,100. The maximum for other charges would be the fixed amount, such as $2,000.

For physicians' charges (other than for surgery) the policy might allow an amount for each visit in the hospital such as $10 per visit up to 31 visits per confinement. If a patient requires surgery, the policy might list procedures and maximum amount payable for these procedures on a SURGICAL SCHEDULE such as this simplified one:

Appendectomy	$400
Kidney removal	$650
Broken arm	$150

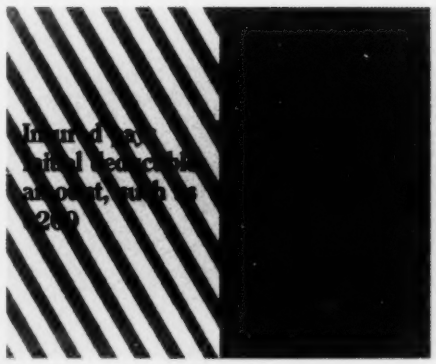
If the patient also has *major medical* coverage, a CORRIDOR DEDUCTIBLE—an amount of the expenses the insured pays after the basic policy has paid some benefits and before the major medical policy continues to pay—may be charged.

Comprehensive and Supplemental Policies

Insurers offer major medical expense benefits in both comprehensive and supplemental policies.

Some major medical policies written on a group basis encourage preventive care by covering the cost of routine physical examinations as well as the treatment of illness.

COINSURANCE



Coinsurance: Insured pays 20%

Insurer pays 80%

CORRIDOR DEDUCTIBLE

Insurer pays benefits as specified under a hospital-medical-surgical plan

Other Health Insurance Products

Kind	Benefits	Coverages
Dental	Payment for dental treatment or services, including replacement of teeth.	Various plans available to pay dental expense are designed to encourage prevention and early treatment.
Vision	Payment for eye examination and corrective lenses.	Policies pay for examination, lenses and frames.
Prescription Drugs	Payment for drugs prescribed by a physician or dentist on an outpatient basis.	Participating providers are reimbursed for the cost of the ingredients and the dispensing of a drug at an agreed-upon fee. The insured may pay a minimum $2-$3 deductible.
Home Health Care	Payment for health services given in the patient's own home.	Designated services given at home by qualified persons other than physicians (such as physical therapists).

Property and Casualty Insurance

Property Insurance

Insurance for individuals, homeowners, and businesses protects the insured against financial loss from perils such as fire, lightning and wind. This insurance covers items such as dwellings, personal property, and automobiles.

Casualty (Liability) Insurance

Individuals may have auto accidents, accidentally injure others, or own property on which a visitor may be injured. Likewise, businesses have premises and operations out of which accidents arise—and products they make can cause injury after having been sold to the consumer.

Casualty (liability) insurance protects insured persons if they are responsible for bodily injury or damage to other persons on their property. The key point is NEGLIGENCE. An insured person sued by an injured person and found negligent in causing or in not preventing the injury is considered legally liable. Insurance protects against financial loss resulting from such legal liability.

Another important casualty insurance coverage, WORKERS' COMPENSATION, is treated in the next chapter. Briefly, employers buy Workers' Compensation because state laws hold employers responsible for injury to employees and establish the benefits to be paid. These insurance policies compensate employees injured on the job for their medical expenses and loss of income.

Crime Protection Policies

Other major lines of insurance in the Property and Casualty classification include various crime protection policies. Insurance can cover loss from burglary, theft, and dishonesty and offer marine insurance and surety bonds for contracts and businesses.

Test Yourself

Circle the correct answer—A, B, C, or D.

1. A parent who wants to provide for the college education of a three-year-old child would purchase a
   A. term insurance policy for 15 years.
   B. family income policy
   C. whole life 15-year paid-up policy.
   D. 15-year endowment policy.
2. In which of the following situations is Whole Life Insurance particularly desirable?
   I. A person needs a large amount of insurance for a specified time period.
   II. A person is interested in both leaving a sum of money to beneficiaries at death and in the benefit of cash loan value.
   III. A business firm wishes to insure the lives of valued executives
   A. II only
   B. I and III only
   C. II and III only
   D. I, II and III
3. All the following coverages would provide an income benefit for an insured's spouse EXCEPT
   A. A family income policy.
   B. A family maintenance policy.
   C. A term policy.
   D. An annuity.
4. Casualty insurance provides protection when
   A. a meteor crashes on one's property.
   B. a house guest falls down the stairs in an insured's home.
   C. your wallet is stolen.
   D. a fire destroys one's business.
5. A person is injured, although not seriously, in a fall at home. This person would most likely be covered by
   A. short-term disability income insurance.
   B. accidental death and dismemberment insurance.
   C. long-term disability income insurance.
   D. property and casualty insurance.
6. The amount an insured pays a provider of health care (usually about 20% of the total bill) is referred to as the
   A. initial deductible.
   B. coinsurance amount.
   C. corridor deductible.
   D. cash value.
7. Basic medical plans differ from major medical plans in which of the following ways?
   I. Basic plans exclude payment for surgery.
   II. The maximum amounts payable are more under major medical coverage.
   III. Major medical policies cover a broader range of hospital charges.
   A. I only
   B. I and II only
   C. II and III only
   D. I, II and III
8. In addition to disability income and medical expense coverages, health insurance plans also may cover all the following expenses EXCEPT
   A. Dental care.
   B. Vision care.
   C. Prescription drugs.
   D. Family maintenance.

Answers

1. D is correct. The face amount of the policy would pay out in 15 years as well as provide that amount of life insurance during the 15 years.
2. C (II and III) is correct. Whole life insurance has a cash loan value, and is used for key person and partnership insurance.
3. All would provide a periodic income benefit for the insured's spouse EXCEPT C.
4. B is the correct answer. "A", "C" and "D" are covered by property or theft insurance.
5. A. The person will most likely recover in a short period of time.
6. B.
7. C.
8. D.

Chapter 5

The Role of Government in Insurance

Key Terms

Medicaid

Medicare

National Association of Insurance Commissioners (NAIC)

Non-Occupational Disability Laws

OASDHI

Social Security Act

Solvency

Trade Association

After completion of Chapter 5, a student should be able to:

- ***. . . explain why the insurance business is a highly regulated industry***
- ***. . . give five reasons for the regulation of health insurance***
- ***. . . give five ways regulation protects the public interest***
- ***. . . compare private insurance plans and government programs in two respects***
- ***. . . list and explain four major governmental programs related to insurance coverage***

Government, both federal and state, is involved in the insurance business, both for regulating and financing health care.

Government as an Insurance Regulator

Business in the United States is said to be based on the concept of free enterprise. The substance of this concept is not that business should be free to do as it pleases, without supervision or regulation, but rather that the consumer is best served if enterprises are free to compete with one another in providing any product or service.

The insurance business appropriately should be singled out for a greater degree of regulation than most other businesses. The essence of insurance is the payment of money by the insured in the form of premiums, in exchange for the insurer's promise of future performance in case of a particular circumstance that may or may not materialize. It is essential that the insurer have the means of fulfilling its promises when the need arises. Government helps to protect the policyholder by making certain the insurer is solvent—having sufficient financial reserves to handle any payment it is likely to be called upon to make.

Another reason for government supervision of the insurance business arises from the technical nature of the insurance contract. Everyone needs insurance in some form or other, and most of us need many different kinds. Yet, few people are able to understand every word and every clause of a long and involved contract. The insurer prepares the contract and the insured (except policyholders in some group policies) has no part in drawing up its terms. Government supervision is a means of making sure that the insurance policy does not contain unreasonable restrictions and limitations that make it of little value to the person seeking protection. Government also has standardized much of health, property and casualty policy language for personal lines.

Most insurance regulation is primarily under control of state government. Each state has its own Insurance Department, usually headed by an Insurance Commissioner. The Department oversees the interests of the public, including consumer complaints, as well as industry matters such as licensing, solvency, and policy approval. The National Association of Insurance Commissioners (NAIC) aims to promote some degree of uniformity in the regulation of insurance by the

various states and to prevent unnecessary duplication of effort by both the regulatory authorities and the insurance companies.

All three branches of government—legislative, administrative, and judicial—participate in the regulation of insurance in one way of another. To a great extent, however, the industry regulates itself. Insurer and trade association groups—such as the Health Insurance Association of America (HIAA) and the American Council of Life Insurance (ACLI)—provide their members with various types of service and information. Industry committees, joining people from many insurers, tackle major common problems, often working with government regulatory bodies to draft legislation, coordinate programs, and formulate action to improve both industry self-regulation and governmental regulation of the insurance business.

Health insurance, in particular, has a high degree of regulation. A number of reasons account for this fact:

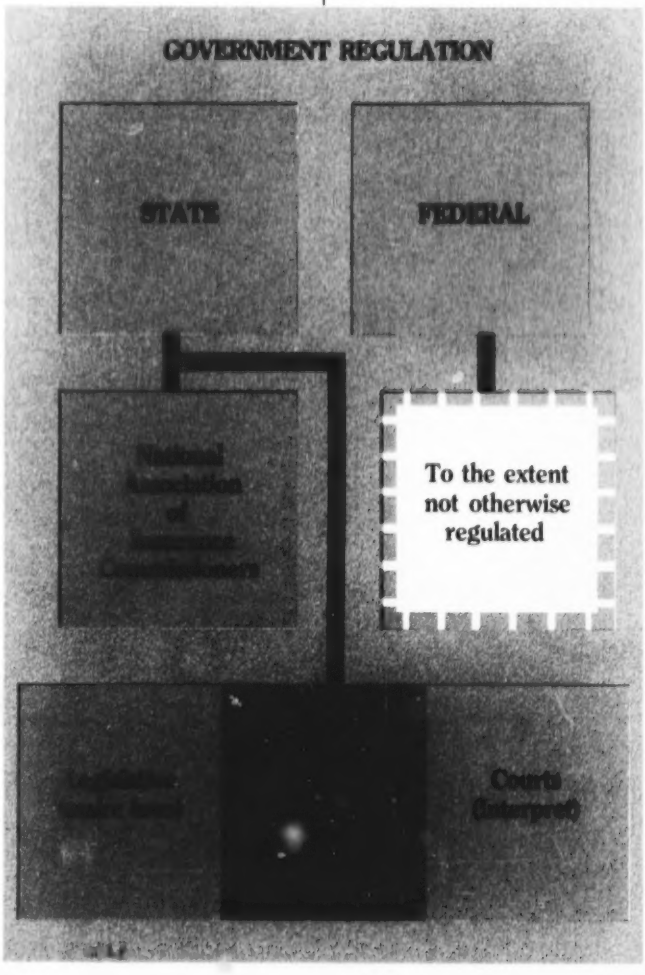
—It is a virtual necessity in today's world of high cost of medical care and delivery.

—A wide range of products are available. The policy is, in good part, an original document developed by the insurer.

—In contrast with life insurance where the insured has only one claim (when he/she dies or exchanges the policy for cash), or fire insurance where few claims occur, multiple claims are very common under health insurance.

—Determining if a loss has occurred within the meaning of the policy can be a difficult task.

—An insured's health can deteriorate, but her/his insurability must be protected.



Regulation, therefore, protects the public interest by

—assuring that the cost of insurance is based on rates which are adequate for insurers but not excessive for policyholders.

—minimizing the chance of insurance being offered by incompetent or unscrupulous insurers.

—making insurance available to as many people as possible, the less desirable as well as the good risks.

—assuring reasonable, fair and equitable treatment of all persons insured.

—encouraging fair competition among insurers according to proper standards of quality, cost and service.

To assure the availability of health care to its citizens, federal and state governments (dominion and provincial in Canada) have passed laws and enacted social programs that cover special insurance needs. Such programs are usually compulsory and funded in most cases by taxation of employers and employees. (Private plans, on the other hand, are voluntary and funded by premiums paid by policyholders.) These programs provide either monetary or service benefits.

Additional public assistance programs, funded from general federal, provincial or state revenues, provide aid to needy persons. Such programs offer:

—Old-age assistance
—Aid to the blind
—Aid to dependent children
—Medical care for handicapped people
—Institutional care for the aged, destitute and others

Government Programs

Administrator	Program	Coverage
Federal Government	Social Security Act: —the Old-Age, Survivors, Disability and Health Insurance Program (OASDHI)	OASDHI provides benefits for death, retirement, disability, and medical care.
	—Medicare	Medicare provides Hospital Insurance (Part A) and Supplementary Medical Insurance (Part B).
Federal and State Government	—Medicaid	Medicaid is a state program of public assistance to persons, regardless of age, whose income and resources are insufficient to pay for health care. The Social Security Act provides matching federal funds for financing state Medicaid programs.
State	Workers' Compensation	This coverage provides weekly income, medical expense benefits, and death benefits for employed persons who are disabled by an on-the-job accident or a work-related sickness.
State (enacted in California, Hawaii, New Jersey, New York, Rhode Island—and Puerto Rico)	Compulsory Non-Occupational Disability Laws	Minimum and maximum weekly disability income benefits for disability not connected to one's job are provided.

Test Yourself

Select and circle the answers you consider correct.

1. Recognizing an inequity between insurer and insured, (the insurer holding a distinct advantage over the insured, yet obligated to serve the public interest), government regulations operate for which of the following purposes?
   A. Make sure that insurers are financially strong enough to meet obligations.
   B. Protect the public from practices that are unfair or unethical.
   C. Make sure everyone pays the same rates.
   D. Set a high standard so that only good risks are insured.
   E. Discourage competition among insurers.
   F. Make sure that insurance is reasonable, fair, and equitable in all respects.
2. Government programs include health insurance coverages under which of the following laws and programs?
   A. OASDHI.
   B. Workers' Compensation.
   C. State Compulsory Disability Laws.
   D. Social Security Act.

Answers
1. A, B, F
2. A, B, C, D

Chapter 6

Organization and Operations of the Insurance Business

Key Terms

Agency System
Blue Cross/Blue Shield Insurers
Branch Office
Brokers
Direct Selling System
Fraternal Insurers
Home Office
Lloyds Insurers
Mixed Marketing System
Mutual Insurers
Reinsurance
Stock Insurers
Third-Party Administrators

After completion of Chapter 6, a student should be able to:

- ***. . . compare and contrast the various types of insurance organizations***
- ***. . . explain the common systems for producing insurance business***
- ***. . . list and explain the major function of insurance operations***

Insurance is a service business with the objective of protecting human and material resources at a fair cost with a fair return for the insurer.

Insurers have several types of organizational structures in which they may operate. The main types of such organizations are outlined below.

Types of Insurance Organizations

Mutual Insurers— Mutual insurance companies are corporations owned by their policyholders. The mutual benefit attitude of such companies means that profits earned may be returned to policyholders in the form of dividends. Not all profits are distributed because some are used for future investment or loss coverage. An attitude of sharing is expressed in public relations and claims, and particularly in loss prevention services where reduction in frequency and severity of losses is money in the hand of both the policyholder and the insurer.

Stock Insurers— These insurance corporations are owned by stockholders who have invested in the company by purchasing shares of stock. There is strong emphasis on profitable operations because stockholders invest money, thereby contributing to the financial strength of the company, and they expect a return on their investment. Policyholders benefit from this strength and the security it affords, and may also receive rate decreases or refunds if the company operates with a plan of policyholder participation.

Fraternal Insurers— Some fraternal organizations offer insurance benefits on a similar basis as commercial insurers. Most fraternal insurers mainly offer life insurance and operate much as mutual companies.

Blue Cross and Blue Shield— These insurers are hospital and medical service organizations. Historically these plans were unincorporated, voluntary and non-profit in nature. However, some have become mutual insurance corporations and potential new tax legislation may have further effects on their tax-exempt status.

Reciprocal Insurers— In contrast to stock and mutual organizations, these insurers exemplify the pure mutual concept. There is no organizational structure; an attorney handles the administration and pays claims. Each member's premiums go into the member's account and claim payments are made from all accounts on a percentage basis. If claim expense exceeds the withdrawals thus determined, members are assessed for the additional amount needed. Reciprocal insurers write property insurance.

Lloyds Insurers— Lloyds organizations—of London and of America—are unique in all ways, as insurance organizations go. As a corporation, Lloyds functions only to supervise transactions and safe-

guard the reputation of the organization. Underwriting, however, is done by individuals and firms that in effect pledge their personal assets for the amount of risk they are assuming. Thus, there are only premiums and losses; the underwriters' fortunes are gain or loss, from good luck or bad. Most of Lloyds' business is in marine, motor and aviation, and some large amounts of life insurance.

The Insurance Production System

Several methods are used by insurers to sell their products. The following are the most common systems for producing insurance business:

Agency System— Both *independent* and *exclusive* agency systems are used by insurers. Independent agents sell insurance for several or many insurers. Many of the largest insurance companies use independent agents (i.e., Aetna Life and Casualty and CIGNA). Property and casualty insurance generally is sold through the independent agency system.

Exclusive agents represent only one insurer. These persons are not employees of the company but have independent contracts to sell insurance for that company and its related companies. An example of a large insurance company using exclusive agents is State Farm.

Direct Selling System— In this system, insurance companies use salaried employees to sell insurance. Those who sell company products are company employees, unlike those who sell through the agency system. These employees have direct contact with the consumer and there is no agency intermediary. The direct selling system may include mail advertising and the writing and servicing of business by direct mail and telephone without use of agents or sales representatives.

Mixed Marketing Systems- Though most insurers use the agency or direct selling systems, there are those who prefer to use a mixture of both systems. This mixed marketing system has proven useful in introducing new products or expanding into new markets.

Brokers— Brokers represent insurance buyers rather than an insurance company. Brokerage firms work with insurance prospects to identify their insurance needs. The broker seeks out an insurance company that will meet the buyer's needs. Brokers resemble independent agents except that they represent the insurance buyer.

The Structure of Insurance Operations

Those functions having DIRECT relationship to the consumer, have already been described. These include:

- Sales
- Claims
- Underwriting
- Loss Control (Property and Casualty)

Many other functions comprise the network of operations not only to support the marketing and product development processes but to conduct all affairs of the organization efficiently and economically toward maintaining a high quality of service to the policyholders. These functions include:

- Administration
- Legal
- Investments
- Advertising
- Public Relations
- Actuarial
- EDP
- Staff Services

Administration
- —issues policies
- —installs plans
- —audits policies
- —bills and collects premiums

Legal staff
- —aids in designing coverages
- —keeps in step with regulations
- —handles claim litigation

Investments
- —maintains the proper cash flow
- —achieves a balance in liquidity, high return and maximum security, from investments of premium income, reserves, and surplus

Advertising and Public Relations
- —keeps up the company image
- —stimulates sales

Actuarial
- —determines rates which are adequate, equitable and competitive, and calculates reserves

Electronic Data Processing (EDP)

Many companies have applied Electronic Computer Techniques to a wide range of functions—
- —keeping records
- —providing reports
- —rating and printing policies
- —budgeting and forecasting
- —management reporting

and have installed claim payment systems to facilitate the processing of large volumes of claims. There are at least three important advantages of computerized claim payment:

1. It produces a printed explanation of benefits form (EOB) which gives a clear and concise description of charges and benefits paid and also serves as a convenient record of payment.
2. The computer performs the arithmetic calculation and also performs some edit checks on the information keyed in by the operator. In this way, errors on claim payments are significantly reduced.
3. A complete record of the claim recorded on tape is used as input for accounting and statistical work.

Staff Services

Many other functions support insurance operations. In these functions people tend to a multitude of details and provide staff assistance. In addition to clerical services are many internal planning, development and technical functions that include Human Resource Development (HRD) activities, Training and Education, Personnel Services, Systems and Procedures, and Office Planning and Services.

Other Operational Structures

In order to market insurance products, administer claims and conduct business, the operations network may vary. For example, most large insurers have a *home office* and *branch offices*. The branch office system is controlled exclusively by the insurer and is managed by a company employee. Activities of branch offices may include sales and claims processing, depending on company structure.

In the past several years, some companies and employers have chosen to self-fund their own plans—particularly in life and health insurance. These non-insured plans of single employer groups frequently hire the services of *third-party administrators (TPAs)* to administer claims payments.

Reinsurers are also a part of insurance company operations. *Reinsurance* is a means of shifting part of the financial risk of one insurer to another. An insurer places part of the risk with a reinsurer and pays a premium for the amount of risk to be assumed by the reinsurer. Reinsurance is insurance for insurers.

Summary

All of these functions—in direct contact with the public and in supportive roles—present challenges and rewards of great proportions for competent insurance people. Insurance places high on the list of professional careers, furnishing high quality professional personal service in delivering the insurance product to the consumer, and fulfilling its obligation to society to protect both human and material resources. The main careers in insurance are presented in Chapter 7.

Test Yourself

Match the phrase to the correct answer.

1._____	Corporations owned by the policyholders	A. Agency system B. Broker
2._____	Corporations owned by investors	C. Direct Selling System D. Advertising & Public Relations
3._____	A pure mutual concept	
4._____	Independent or exclusive	E. Mutual Insurers
5._____	Producers are company employees	F. Reciprocal Insurers G. Third-Party Administrators
6._____	Represent the insurance buyer	H. EDP
7._____	Modern recordkeeping system	I. Actuarial Services J. Stock Insurers
8._____	Non-insured claims services	K. Lloyds Insurers L. Reinsurance
9._____	Insurance for insurers	

Answers

1. E
2. J
3. F
4. A
5. C
6. B
7. H
8. G
9. L

Chapter 7

Insurance Careers

Key Terms

Actuary
Advertising & Public Relations Specialist
Agent
Attorney
Broker
Claims Personnel
Electronic Data/ Computer Systems Specialist
Field Representative
Financial Specialist
Group Representative
Human Resource Development Specialist
Insurance Consultant
Librarian
Marketing and Sales Personnel
Medical & Health Care Professional
Risk Manager
Staff Assistant
Third-Party Administrator
Underwriter

After completion of Chapter 7, a student should be able to:

. . . list the main types of careers in the insurance industry

. . . explain the main tasks of each career type

The insurance industry offers many responsible positions in a wide array of careers. Though there are many diverse positions specific to types of company, the first section of this chapter presents those positions common to all insurers. Those positions specific to certain insurers are explained later in this chapter.

Depending on one's interest, education and experience, the insurance industry offers many career choices and opportunities for career growth and challenges.

Major Insurance Careers

Actuaries

The actuary is an accredited, professionally trained person in insurance mathematics. Using mathematical and statistical information, the actuary calculates rates, reserves, and dividends. This person also makes statistical studies and reports. The work of actuaries is key to the business of insurance because it focuses on analysis, forecasting and planning. Actuaries work with key personnel to ensure that company policy and practices are profitable.

Advertising & Public Relations Specialists

This type of work involves a variety of communications directed at policyholders and the insurance-buying public.

Persons in these fields may develop advertising campaigns, informational programs, press releases, booklets, reports and speeches which promote a company's products and image.

Attorneys

Attorneys are involved in many aspects of the insurance business. Primarily they are important in helping to design sound legal policies and contracts that conform to state and federal regulations. Attorneys also represent the company in all legal matters.

Claims Personnel

The claims personnel are known by a variety of titles, depending on the type of company and position—*insurance adjustors, claims correspondents, claims investigators,* and *claims examiners.* No matter the title, all claims personnel ensure that the insurance company fulfills its contractual promises to provide protection. Claims personnel must be aware of the company policies, procedures and interpretations. The work includes close communications with the marketing and legal departments as well as medical staff and the medical community.

Electronic Data/ Computer Systems Specialists

The impact of computers on the insurance industry has created many career openings. Word processors, computer programmers, system analysts, data processors and other related positions are central to the data storage, information processing and statistical needs of insurance companies.

Financial Specialists

A variety of financial specialists is needed to operate an insurance company. Among the main professional careers are: *accountants,* who are responsible for establishing and supervising a company's accounting and control procedures as well as dealing with state and federal tax laws and regulations; *economists,* who provide data, information and forecasting about the relation of economic conditions to the insurance industry; *investment specialists,* who furnish service to their employers in relation to investing company funds in securities and real estate for a profitable return.

Human Resource Development Specialists

HRD staff may be responsible for a variety of tasks, depending on the size of a company. Some of these tasks are hiring, company orientation skills training, continuing education, and career development. It is important for HRD staff to know their company philosophy and products and use this knowledge to strengthen the quality of work of all personnel.

Marketing & Sales Personnel

There are many types of sales and marketing personnel in the insurance industry. Several of them are described in Chapter 6. No matter the title or the type of responsibility, these people operate in a highly competitive and changing marketplace to sell the products and services of insurance companies.

Staff Assistants

Essential to the internal operation of all insurance companies are staff assistant services. These positions include secretaries, stenographers, receptionists, office managers, mailroom personnel and many related positions needed in all companies.

Underwriters

The underwriter is responsible for evaluating risk to determine the basis on which it will be acceptable to the insurer. Among the chief tasks of the underwriter are setting up rules to underwrite new and existing policyholders, reviewing evidence of insurability, and establishing basic premium rates that can be expected to produce a reasonable profit for a company.

The career positions just described are the most common to all insurance companies. The next section describes related positions and those common to specific types of insurers or organizations.

Other Insurance-Related Careers

Depending on the type of insurance products, size or organization of companies, many additional careers are available in the insurance industry. The most common of these are explained below.

Agents

These persons represent insurance companies by analyzing

and advising consumers in relation to their insurance needs. Some agents work directly for a company and receive a regular salary and/or commissions; other agenst represent several companies and receive a commission for each sale made. To be an agent, a person must be licensed in the state in which he/she sells.

Brokers

Brokers represent an individual or a group. Their function is to negotiate with an insurer for individual or group insurance for their client. Brokers are usually involved in writing large group policies.

Field Representatives

Field representatives are a liaison between insurance companies and insurance agents and brokers who sell the company's policies. They are responsible for making sure agents and brokers understand important developments in the business as well as changes in company practices. These people work with many types of personalities and frequently have contact with the public by speaking to organizations, groups, and schools.

Group Representatives

Group representatives are employed by insurance companies to sell and service group plans written for employers and their employees.

Insurance Consultants

Insurance Consultants operate independently, providing design, sales and service to employer groups.

Librarians

Most insurance companies need libraries which contain books and materials relating to the laws, research issues and programs of insurers. The librarian assumes the duty of cataloging and maintaining the company library and providing information and materials.

Medical & Health Care Professionals

Physicians, nurses, health educators, physical and vocational therapists are among the many health care specialists used in the life and health insurance industry. Medical examinations for insurability, input into underwriting, wellness programs, and rehabilitation programs are some of the important contributions made by these professionals.

Risk Managers

These persons are usually employed by firms other than insurance companies to advise on the protection of a company's property, personnel and products. They seek to prevent or minimize losses due to property damage, injury or dangerous products.

Third-Party Administrators

These persons are hired by employers to administer group insurance plans. Large companies, associations or labor-management groups may fund their own insurance programs and employ the TPA to manage the program and process claims.

As you can see from Chapter 7, there are many challenging and interesting careers in the insurance industry. As the insurance field grows and changes, new careers develop and new opportunities become available.

Test Yourself

Answer True or False.

1. _____ Field Representatives sell insurance.
2. _____ Few life and health insurance companies hire medical _____ professionals.
3. _____ Insurance brokers and agents are the same thing.
4. _____ Risk managers determine the rates of insurance _____ policies.
5. _____ Third-party administrators are hired by self-insured employers.

Complete the following statements:

6. The area of financial specialist includes what three professional careers? _____, _____, and _____.
7. The underwriter evaluates _____ to determine the basis of acceptable insurability.
8. _____ ensure that an insurance company fulfills its contractual promises to provide protection.
9. Rates, reserves and dividends are calculated by the _____.
10. Career positions related to data storage and information processing include _____, _____, _____, and _____.

Answers

1. False
2. False
3. False
4. False
5. True
6. accountants, economists, investment specialists
7. risk
8. claims personnel
9. actuary
10. word processors, computer programmers, system analysts, and data processors.

Chapter 8

The Challenges of Today's Insurance Industry

Key Terms

Cafeteria Plans
DRG
ERISA
Hospice Care
HMO
Managed Health Care
Multi-line Products
No-fault Insurance
PPA
Unbundling
Unisex

After completion of Chapter 8, a student should be able to:

- ***. . . describe several new organizational and product developments in the insurance industry.***
- ***. . . explain current thrusts of the health, life and property/casualty business.***
- ***. . . list and explain five current challenges to the insurance industry.***
- ***. . . name the major insurance education programs.***

The Current Scene

The insurance industry is a challenging and changing business. In order to remain competitive, insurers must offer the types of service and products that meet the needs of society. As society and its laws change, new coverages and procedures are developed.

The current insurance scene indicates that the move for low cost and convenient services is having impact on the organization of insurers. A number of insurance companies have merged with another company and large companies have acquired smaller ones. Diversification and thrust toward MULTI-LINE products have occurred in many companies.

Insurance companies frequently offer a PACKAGE of policies for all of a family's insurance needs—property liability, life and health. Still other companies have UNBUNDLED services to allow the buyer to pick and choose among services and products.

As legislation on the federal and state level changes, new products, coverages and rates will be developed. Some recent examples are: the Employee Retirement Income Security Act (ERISA) which affects prudent funding of pension plans; UNISEX LAWS that affect the rating of insurance by sex; NO-FAULT auto insurance in which state law affects auto-insurance products, and DRGs (Diagnostic Related Groups) by which the federal government attempts to establish maximum hospitalization for specific medical services.

Let's take a closer look at insurance today.

Health Insurance

Health insurance is constantly affected by social, legal and medical changes.

Cost containment of skyrocketing health costs has created many new products and delivery systems. COINSURANCE, described in Chapter 4, is one development to contain costs and minimize abuse of the health care system.

Health Maintenance Organizations (HMOs) and Preferred Provider Arrangements (PPAs) are two types of health insurance systems aimed at controlling costs, particularly those of hospitals and physicians. These systems are part of a new concept called MANAGED HEALTH CARE.

Some insurers have developed CAFETERIA PLANS which allow persons insured in group plans to choose for varying premiums the type of insurance coverage they want. For example, a woman in her late forties may not wish vision care coverage but would like a dental plan for herself and her children. Costs are adjusted for what she chooses.

Due to an increase in life expectancy and new techniques in rehabilitation, a greater demand has developed for long-

term health care services. Nursing homes and rehabilitative centers are provider systems which challenge health insurers for new products and services.

The health insurance industry has been intensifying its efforts to motivate people to be concerned with health care and to educate them to use the medical care system effectively. Many concepts are pursued by insurers—including wellness and fitness programs, surgical centers and same-day surgery, home health care, prevention and early detection of disease, second-opinion surgery, and HOSPICE CARE for the terminally ill.

Life Insurance

The Life part of our industry is adaptive to economic and social trends, such as inflation, increased employment of women, new family patterns, new income standards, new consumer marketing habits and increased life expectancy.

The marketplace, always competitive, is growing even more so. With increasing consumer awareness of high returns in the money market, the insurance industry is seeing a future scene that is market-oriented as well as client-oriented.

Among the most competitive products developed for a changing market are:

Variable Premium Life— Policies are being designed featuring premiums that reflect economic expectations, mortality tables, investment yields and expenses.

Indexed Life Policies— "Indexed Life Policies" adjust the face amount of the policy according to the Consumer Price Index, counteracting the negative effects of inflation.

Universal Life— There are life insurance policies in which the amount of interest, earned over a fixed guaranteed rate, is paid on the cash value of the policy. With others, the benefit increases or decreases according to investment results from assets invested in common stocks and other equity-type securities.

Adjustable Single Premium— An adjustable single premium whole life policy is designed so that a policyholder can use the cash value at a particular time to buy paid-up life insurance—an attractive feature for people approaching retirement age.

Variable Annuities— Variable Annuities provide a retirement income with a built-in hedge against inflation.

Life Cycle Policies— This type of policy provides all the insurance needs of a policyholder in a single policy, in which coverage, premiums and face amount can change as life circumstances change.

Property and Casualty Insurance

Many new types of insurance have appeared in the property-casualty field, such as sky-jacking insurance, insurance to protect clients against the failure of securities brokers, insurance for mechanical breakdown of new and used cars, and insurance protection for victims of mugging.

Also on the scene are compulsory auto liability insurance and compensation of crime victims for medical care expense.

Challenges have recently come in the area of liability insurance to which the industry is responding. Product liability suits and medical malpractice suits have escalated heavily in the past several years. The insurance industry has been actively engaged in seeking to control these risks so that the consumer is not unjustly burdened.

The areas of personal property and casualty insurance have responded to consumer needs by developing many types of choices at varying rates. Insurance premiums are assessed on a regular basis to ensure that the policyholder is adequately covered for current value—including the effect of inflation.

Cost containment has been addressed, too, with such devices as deductibles for property insurance.

Many insurers are now encouraging the marking and videotaping of insured valuables. This practice increases the chance for recovery of lost or stolen items and helps to protect the policyholder by enabling more accurate replacement cost evaluation.

Responding to Industry Challenges

The insurance industry is faced with many challenges, as can be seen in the preceding chapters. Changes in society, life span, medical developments or life style create some of these challenges. Many times these challenges are met by new products and services which aid the consumer and society.

Sometimes the challenges are the result of government action or government policy. The result may be the modification of products and policies to conform to new laws. Other times the insurance industry is challenged to develop new product lines which are demanded by society.

On other occasions social, political and demographic challenges occur that must be

met by an active commitment of various groups—the insurance companies, other businesses, lawmakers, medical and other professional groups. Some of these challenges include:

AIDS— and other catastrophic diseases which require research, services and cost-effective insurance coverages working cooperatively.

The Uninsured— those persons who for various reasons lack adequate health, retirement, auto or other insurance protection and may place a burden on society or themselves.

Excessive Liability Judgments— which have resulted from an increasingly litigious society and caused an increase in various insurance rates or availability of policies.

The Aging of America— causing an increase in the number of aging Americans and creating the need for new forms of personal insurance protection.

Consumer Demands— which grow and change with social changes and create the need for providing new products and insurance service delivery.

These are but some of the many continuing challenges to the insurance industry. As in the past, industry leaders, insurance associations and creative industry employees will address the challenges and develop new products and services to protect society.

Furthering Your Understanding

This booklet is intended as an introduction to the business of insurance. To increase your knowledge, skills or career potential, there are many insurance industry courses of study available to you. You can learn about them from an insurance company Training Director or Personnel Department or by writing directly to the programs listed below.

Among the major Insurance Education Programs are:

The Health Insurance Association of America Insurance Education Program
1025 Connecticut Avenue NW
Washington, DC 20036
202 223-7852

Provides the most comprehensive study courses dealing with the Group Life and Health and Individual Health Insurance businesses. The technical and socio-economic knowledge gained through these courses is recognized for academic credit as well as continuing education credits for state licensing.

Life Office Management Association (LOMA)
5770 Power Ferry Road
Atlanta, Georgia 30327
404 951-1770

Provides comprehensive courses in the area of the Life Insurance business and its management which lead to a Fellow Life Management Institute (FLMI) designation.

Society of Actuaries
500 Park Blvd.
Itasca, IL 60143
312 773-3010

Provides the complete course of study for professional certification as a life and health actuary. Completion of this rigorous program confers the title of Fellow of the SOA.

Casualty Actuarial Society
One Penn Plaza
250 West 34th Street
New York, NY 10119
212 560-1018

This complete course of study about property-casualty actuarial science leads to becoming a Fellow of CAS.

International Claims Association (ICA)
c/o LOMA
5770 Power Ferry Road
Atlanta, Georgia 30327
404 951-1770

Sponsors an education program designed to provide students with a thorough understanding of claims administration in the life and health insurance industry. Certain courses in the HIAA, LOMA and CLU education program serve as prerequisites to enrollment.

The Insurance Institute of America; American Institute for Property & Liability Underwriters
720 Providence Road
Malvern, PA 19355
215 644-2100

The American Institute oversees the complete education program for the CPCU Program (chartered property-casualty underwriter). The IIA offers specialty associates study in property-casualty claims, underwriting, loss control and related areas.

American College
270 Bryn Mawr Avenue
Bryn Mawr, PA 19010
215 896-4500

This complete education Program for Charter Life Underwriters (CLU) or Chartered Financial Consultant (ChFC) covers various areas of life insurance, financial, pension and estate planning as well as management and underwriting.

In addition to these insurance education programs, many other professional organizations provide seminars, educational materials and newsletters to aid persons interested in keeping their knowledge of the insurance industry up-to-date.

Test Yourself

1. The current insurance scene includes all but which service development?
   A. Multi-line products.
   B. Packaged policies.
   C. Stock brokerage services.
   D. Company merges.
2. Which of the following is NOT an effect of government intervention on the insurance industry?
   A. Unisex rate laws.
   B. Child care legislation.
   C. No-fault auto laws.
   D. DRGs.
3. Effects of cost containment efforts include which of the following?
   I. HMOs.
   II. PPAs.
   III. Coinsurance.
      A. I only
      B. III only
      C. I and II only
      D. I, II and III
4. Match the following to the current insurance business:

1._____	Wellness Programs	
2._____	Variable annuities	A. Health Insurance
3._____	Videotaping	B. Life Insurance
4._____	Hospice care	C. Property/Casualty
5._____	Skyjacking insurance	
6._____	Indexed Policies	

5. Mark (T) True or (F) False.
   _____A. Social change affects the insurance industry.
   _____B. Consumer demand is generally unimportant in developing insurance products.
   _____C. The "Aging of America" is mostly an issue for the Health Insurance industry.
   _____D. There are three major Insurance Education Programs available to industry employees.

Answers

1. C—All the rest directly relate to insurance services.
2. B.
3. D—HMOs, PPAs and Coinsurance are all cost containment systems.
4. 1. A
   2. B
   3. C
   4. A
   5. C
   6. B
5. A. True
   B. False
   C. False
   D. False

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